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CHARLES ELMORE

Supreme Court of the United States

OCTOBER TERM, 1931.

No. [redacted]-52

HUBERT DALTON and FLORENCE W. DALTON,
Petitioners,

against

FRANK C. BOWERS, as Executor of the Last Will and Testament of Frank K. Bowers, as Collector of Internal Revenue of the United States for the Second District of New York,
Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF.

ARNOLD LICHTIG,
Counsel for Petitioners.

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PETITION FOR WRIT OF CERTIORARI.

MAY IT PLEASE THIS HONORABLE COURT:

The petition of Hubert Dalton and Florence W. Dalton respectfully shows:

(A)

Summary Statement of the Matter Involved.

The Circuit Court of Appeals for the Second Circuit on February 23, 1932 has reversed a judgment of the United States District Court for the Southern District of New York entered March 26, 1931 for $56,841.32, being the amount paid under protest for additional income taxes assessed by the Commissioner of Internal Revenue for 1924

and 1925, resulting from the Commissioner's refusal to carry forward to 1925, a conceded 1924 loss of $374,078.98 on the sole ground that such loss was not sustained in a business regularly carried on by the taxpayer.

The precise question here involved has also arisen in the Eighth Circuit where the Circuit Court of Appeals sustained petitioner's contention.

The decisions in the two circuits are in flat contradiction to each other.

The facts, which are undisputed, are summarized as follows:

Hubert Dalton, one of the petitioners, since 1914 and including 1924-1925 (the years here involved has continuously been engaged in business, regularly carried on by him, as inventor, designer of patents, promoter and exploiter of such patents, and the manufacture and marketing, through corporations organized by him especially therefor, of such patented articles (R. 23, 24, 35). To these corporations he transferred some of his Letters Patent, which included over a thousand of his ideas, and thus far he has organized and controlled six of such corporations (R. 29, 32-36, 45).

He maintained at his own personal expense two separate and completely equipped workshops, one at his home in Connecticut and one at his office in New York City. These workshops, and his office had no connection with his corporations (R. 30, 31).

He gave his personal attention to the management of the various companies which he organized for the exploitation of his patents, received no salary, although some was credited to him on the books for a time (R. 43, 53). He hoped to profit as a result, not alone by employing his cap-

ital, but also by the labor expended by him in development of his companies, by the use of which he hoped to so popularize his inventions that he might dispose of his patent rights. His opportunity of profit, and his risk of loss, depended upon the proceeds of the sale of his stock in the corporation, and he endeavored, unsuccessfully, to dispose of such stock from time to time (R. 55). Petitioner had no other business. The profit on the sale of the patents, through the sale of the stock in such corporations, or the loss on such sale, was the profit or loss resulting to the petitioner in his business which he regularly carried on for so many years and in which he was daily engaged.

One of the corporations so utilized by the petitioner in his personal business was the Dalton Manufacturing Corporation which he organized, controlled, managed and directed, acquiring all the capital stock of said corporation at a cost of $395,000 (R. 5, 27). The venture was unsuccessful. Petitioner was unable to dispose of the stock in the Dalton Manufacturing Corporation, and the $395,000 capital employed by petitioner in such venture became a loss in 1924, when the Commissioner ascertained the stock to be worthless. Of this conceded loss petitioners sought to carry over $374,078.98 to 1925 as a "net loss", but the Commissioner disallowed such deduction.

An additional tax of $56,841.32 was assessed for the year 1925 and paid under protest, and this suit was then instituted for its return. The District Court sustained petitioners' contention and awarded judgment in their favor, but such judgment was reversed by the Circuit Court of Appeals.

In so reversing, the Circuit Court of Appeals held that Hubert Dalton was not engaged in the type of business in which a "net loss" might be sustained saying that "Con-

gress intended to give relief to persons engaged in an established business for losses incurred during a year of depression in order to equalize taxes in the two succeeding and more profitable years".

Such decision is directly contrary to that in *Washburn* v. *Commissioner*, 51 Fed. (2d) 949 where the Circuit Court of Appeals for the Eighth Circuit under similar (and legally indistinguishable) facts held that a "net loss" was sustained in a similar type of business and permitted a taxpayer to deduct the cost price of corporate stock as a "net loss" where the taxpayer controlled and operated the corporation and utilized it in connection with his personal business (just as petitioner, Hubert Dalton, controlled and utilized the Dalton Manufacturing Corporation).

The question involved was squarely presented and determined by the Eighth Circuit and the Court there, in a comprehensive and learned opinion, reached a conclusion contrary to that reached by the Second Circuit in this case. It is to review this decision that the present application for certiorari is made.

(B)

Reasons Relied on for Allowance of Writ.

1. The decision of the court below erroneously construes section 206 (a) and (b) of the Revenue Act of 1924, and Article 1621 of Treasury Department Regulations 65, in holding that a loss sustained by an individual engaged in a personal business, regularly carried on by him in connection with the acquisition of stock in a corporation organized, managed and controlled by him and utilized in furtherance of his personal business as a branch, arm, and instrumentality thereof, may not be carried forward as a

"net loss" and deducted in the following year. The text of the statute and regulations is set forth in petitioners' brief in this application, presented herewith.

2. The decision of the court below is in irreconcilable conflict with that of the Circuit Court of Appeals, Eighth Circuit, in *Washburn* v. *Commissioner,* involving the identical principles and decided upon a state of facts practically identical with that in the case at bar, where a directly contrary conclusion was reached. No certiorari to review that decision was applied for and the time for same has expired.

3. The Board of Tax Appeals, both prior to and since the decision in *Washburn* v. *Commissioner,* adopted and followed the rule and principle approved by that decision, but can no longer do so, and if the rule adopted in the Second Circuit is to be taken as authoritative, confusion will necessarily result. Until the conflicting decision in the case at bar, the ruling in *Washburn* v. *Commissioner* stood as the controlling judicial interpretation of the law on this subject.

4. Notwithstanding the merits of petitioners' contention, the question should not be left in its present state of hopeless confusion. Only by granting a writ of certiorari and an authoritative holding by this Court, can the confusion and conflict of authorities be remedied.

Wherefore your petitioners respectfully pray that a writ of certiorari out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second District, commanding that Court to certify and to send to this Court for its review and

determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 11,685, Hubert Dalton and Florence W. Dalton *v.* Frank C. Bowers, as Executor of the Last Will and Testament of Frank K. Bowers, as Collector of Internal Revenue of United States for the Second District of New York, and that the decree of said Court may be reversed by this Honorable Court and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioners will ever pray.

April, 1932.

HUBERT DALTON and FLORENCE W. DALTON,

By: ARNOLD LICHTIG,

Counsel for Petitioners.

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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1931.

HUBERT DALTON and FLORENCE W. DALTON,
Petitioners,

against

FRANK C. BOWERS, as Executor of the Last Will and Testament of Frank K. Bowers, as Collector of Internal Revenue of the United States for the Second District of New York,
Respondent.

BRIEF FOR PETITIONERS ON APPLICATION FOR WRIT OF CERTIORARI.

This application is for certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit entered February 23, 1932, reversing the United States District Court for the Southern District of New York, which had awarded petitioners a judgment in the sum of $56,841.32 and interest for the return of income taxes claimed to have been illegally collected for the year 1925.

The opinion below is reported in 56 Fed. (2) 16.

Jurisdiction.

Jurisdiction to review is conferred by Section 347 of the Judicial Code providing that in any case, civil or criminal, in a Circuit Court of Appeals, it shall be competent for the Supreme Court, upon the petition of any party thereon, to require by certiorari that the cause be certified

to the Supreme Court for determination by it with the same power and authority, and with like effect, as if the cause had been brought either by unrestricted writ of error or appeal. The decree below was entered February 23, 1932 (R. 194) and this application is made within the three months period prescribed by Section 350 of the Judicial Code.

The present case is one specified in Rule 38, par. 5, Subd. (b) of this Court "where a Circuit Court of Appeals

> (1) has rendered a decision in conflict with a decision with another Circuit Court of Appeals on the same matter,
>
> (2) has decided an important question of general law in a way probably untenable in conflict with the weight of authority,
>
> (3) has decided an important question of Federal law which has not been, but should be, settled by this court."

Statement of Case.

A complete statement of the facts, with reference to the record, appears in the petition presented herewith under subdivision (A) entitled "Summary Statement of the Matter Involved" (pages 1 to 4 of petition).

Statutes Involved.

The pertinent provisions of the Revenue Act of 1924 are as follows:

> Sec. 206 (a) "As used in this section, the term 'net loss' means the excess of the deductions allowed by Section 214 or 234 over the gross income, with the following exceptions and limitations:

(1) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business; * * *

(b) If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called 'second year') and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called the 'third year'); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary."

The pertinent provisions of Treasury Department Regulation 65 are as follows:

Art. 1621. *"Net losses, definition and computation.* The term 'net loss' as used in the Statute applies to a net loss during the taxable year in a trade or business regularly carried on by the taxpayer. Included therein are losses from the sale or other disposition of real estate, machinery and other capital assets used in the conduct of such trade or business. In order to be entitled to claim an allowance for a 'net loss' the taxpayer must have suffered an actual net loss in a trade or business during the taxable year."

Conflict of Decisions in the Circuit Court of Appeals.

In *Washburn* v. *Commissioner,* 51 Fed. (2d) 949 (*decided August 11, 1931*) the Circuit Court of Appeals for the Eighth Circuit, held that a "net loss" was sustained and was properly carried over to a succeeding year, where an individual taxpayer sustained a loss in the capital stock of a corporation, which he organized and used as a part of his personal business. The loss was an "isolated loss", no similar one being incurred. Nevertheless, it was held that it was incurred in a general business regularly carried on and constituted a "net loss".

The Circuit Court of Appeals in the Second Circuit in the instant case (*decided February 15, 1932*) held the exact opposite; namely, that a "net loss" was not sustained and could not be carried over to a succeeding year where an individual taxpayer sustained a loss on the capital stock of a corporation which he organized and used as part of his personal business. The loss was an "isolated loss", no similar one being incurred. For that reason, it was held that it could not have been incurred in an established business regularly carried on and could not constitute a "net loss".

The two decisions are in irreconcilable conflict with each other. The two cases are not legally distinguishable on their facts, although the businesses of the taxpayers involved were somewhat different.

The court below, in its opinion stated the facts in *Washburn* v. *Commissioner* and said

> "These facts, perhaps, distinguished the case from the instant one."

The use of the word "perhaps" indicates that the distinction is more imaginary than real.

Specification of Errors.

1. The Circuit Court of Appeals erred in holding that the loss was not a "net loss" within the meaning of section 206 (a) and (b) of the Revenue Act of 1924 and Treasury Department Regulations 65, Article 1621.

2. The Circuit Court of Appeals erred in holding that the loss was not sustained by the taxpayer in a trade or business regularly carried on by him during the taxable year.

3. The Circuit Court of Appeals erred in refusing to carry over to the year 1925, and in refusing to deduct from the gross income for that year, the "net loss" sustained by the taxpayers for the year 1924.

4. The Circuit Court of Appeals erred in reversing the judgment of the United States District Court for the Southern District of New York.

Summary of Argument.

The petitioner Hubert Dalton was engaged in a personal business regularly carried on by him from 1914 to date, and he was regularly engaged in that business, and none other, during the year 1924 when the loss was sustained.

Congress has not distinguished between different classes or types of business, and the Revenue Act applies with equal force to *any* trade or business so long as it is regularly carried on by the taxpayer.

There is a distinction between an "isolated transaction" and an "isolated loss". An "isolated transaction" does not constitute a "business regularly carried on", whereas an "isolated loss" is a single or infrequent loss sustained in a "business regularly carried on".

The taxpayer being engaged in a business regularly carried on by him since 1914 and having utilized the Dalton Manufacturing Corporation (as he did others) in furtherance of his own business and as an instrumentality thereof, the loss sustained in connection with the stock of that Corporation was a loss in the personal business of the taxpayer.

Being a loss sustained in taxpayers' personal business, regularly carried on by him in the taxable year, the same constituted a "net loss" and may be carried over as a deduction for the following taxable year.

The decision below is in flat contradiction to the correct rule as declared and applied in the Eighth Circuit.

ARGUMENT.

In *Washburn* v. *Commissioner*, 51 Fed. (2) 949, KENYON, Circuit Judge, writing for the unanimous court, stated the point involved to be (page 951):

> "Was the petitioner regularly operating a trade or business?"

and in permitting an "isolated loss" in corporate stock to be carried over and deducted as a "net loss", said:

> "to avail himself of the deduction provided by section 204 (a) of the Revenue Act of 1921, *supra*, petitioner must show that the loss resulted from the operation of some trade or business regularly carried on by him."

When the same question arose in the case at bar, MANTON, Circuit Judge, held squarely to the contrary, finding a different intention in the Statute, and said (R. 191):

> "By the statute, allowing the deductions and carrying over the loss for two years, Congress intended to

give relief to persons engaged in an established business for losses incurred during a year of depression in order to equalize taxation in the two succeeding and more profitable years."

The same contention, as to the intent of the Statute, was made in the *Washburn* case, but overruled as follows (page 952):

> "Respondent contends that petitioner was a mere investor; that the statute is restricted in its application to taxpayers whose income is derived from regular trade with others, such as merchants, manufacturers, and those who have paid taxes on incomes reflected by inventories."

The Eighth Circuit then discussed the meaning of the word "business" as used in the statute and after considering several decisions of this Court, and supporting these petitioners' contention, said (page 953):

> "the statute does not provide that to secure the benefits the taxpayer must be engaged in only one business. It is to *any* 'trade or business'. A party may be engaged in many kinds of business and still be entitled to the benefit of the statute."

Thus the decisions of the Eighth Circuit and Second Circuit are in direct conflict concerning the intention of Congress and the meaning of the word "business" as employed in the Revenue Acts with respect to a "net loss".

At bar, the court below, referring to the statute, also said (R. 191):

> "It was not intended to apply to occasional or isolated losses. Congress has made this distinction."

By that statement the Court failed to distinguish between "isolated *losses*" and "isolated *transactions*".

In the *Washburn* case the Court said (page 953):

> "An isolated transaction in itself would not be a business regularly carried on, but it could well be part of a general business."

The taxpayers' loss on the sale of the stock in the railroad corporation was an "isolated loss", and when the Court permitted its deduction as a "net loss", it necessarily held that Congress did not make the distinction as stated in the opinion in the instant case.

The learned court below said, in effect, that the corporate entity of the Dalton Manufacturing Company cannot be disregarded for the purpose of crediting petitioners with this loss. However, petitioners do not seek credit for any corporate loss. It was their own individual loss of what was paid for the stock in this corporation which they desire to deduct, similar to the loss deducted in the *Washburn* case, where the court, quoting in part from a decision of the Board of Tax Appeals, said (page 955):

> "'* * * upon the sale of stocks or bonds or failure or liquidation of the corporation, the stockholders or bondholders may sustain an operating loss, which is different from the operating loss of the corporation * * * 'It is obvious that an individual may suffer a 'net loss' within the meaning of the Statute upon the failure of a corporation or a sale or other disposition of his interest therein.'"

On the facts, the *Washburn* case and instant case are indistinguishable. In both cases the taxpayers employed corporations as instrumentalities of their personal businesses, in order to promote the general enterprise in which

each was engaged respectively. In the *Washburn* case the Court said (pages 953-954):

> "Much is said in argument as to petitioner being engaged solely in holding the securities of the enterprises in which he was interested, and that he was a mere investor receiving the ordinary returns of ownership. A party may have investments in corporate stock, have no particular occupation, and live on the return of his investments. That would not constitute business under the statute in question. *He may, however, take such an active part in the management of the enterprise in which he has investments as to amount to the carrying on of a business.*"
>
> * * * * * *
>
> "The business of petitioner was not merely looking after investments or reaping the return of past labor represented thereby. He had an office with a complete organization, and gave personal attention to, and participated in, the management of these various companies and enterprises in which he had the investments, not for the purpose of conserving them merely, but of carrying them on successfully and making them profitable. To this he gave his entire time, receiving no salary, except such as might cover his expenses. His work for these different enterprises was not merely sporadic, but was a continuous and regular carrying on. Petitioner testified he worked as hard at his new line of work as he did when he was practicing law. *His income was the result, not alone of his investments, but also of his labor expended in connection with the management of the companies in which he had such investments. The combination of the two is his vocation.*"

Such language applies with equal force to the business of the taxpayer at bar, who took such an active part in the

management of the enterprise in which he has investments as to amount to the carrying on of a business.

This taxpayer also had an office with a complete organization, gave personal attention to, and participated in, the management of these various companies and enterprises in which he had the investments, not for the purpose of conserving them merely, but of carrying them on successfully and making them profitable. To this Mr. Dalton gave his entire time, receiving no salary although some was credited to him on the books. "His work (like Mr. Washburn's) for these different enterprises was not merely sporadic but was a continuous and regular carrying on. He worked hard in his business and his (anticipated) income was the result not alone of his investments, but also of his labor expended in connection with the management of the companies in which he had such investments. The combination of the two is his vocation." There is no distinction in the two cases on the facts—the parallel is too complete.

The *Washburn* case, in construing the statute involved, reached a conclusion in accord with that previously reached and applied by the Board of Tax Appeals.

The recent cases decided by the Board of Tax Appeals (both before and after the *Washburn* case) uniformly held that a loss on stock of a corporation, utilized by the taxpayer as a part or instrumentality of his personal business, regularly carried on by him, is properly deductible as a "net loss".

Examples may be found in the following cases, all involving a single, non-recurring loss on corporate stock, and in all of which the construction contended for by the petitioners was adopted and followed:

Heaslet v. *Commissioner*, 23 B. T. A. 50;
Anthony v. *Commissioner*, 20 B. T. A. 5;

Averill v. *Commissioner*, 20 B. T. A. 1196;
Potter v. *Commissioner*, 18 B. T. A. 549.

The present conflict of decisions should be settled by an authoritative decision of this Court.

April, 1932.

ARNOLD LICHTIG,
Counsel for Petitioners.

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